LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS
200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 6927 | **NOTE PREPARED:** Jan 7, 2012
BILL NUMBER: HB 1337 | **BILL AMENDED:**

SUBJECT: Tax Administration.

FIRST AUTHOR: Rep. Turner | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *Electronic Transmission*: This bill requires for the electronic transmission of certain governmental information instead of transmitting paper documents.

Business Preference: The bill provides that the local Indiana business preference applies to a contract for a purchase made by a political subdivision only if the political subdivision provides that the preference is applicable to the purchase. It repeals the local Indiana business preference for public works projects.

Personal Property: This bill permits a county, city, or town to authorize a 100% property tax deduction for all personal property or, alternatively, to grant a tax credit for all property taxes imposed on all personal property in the county, city, or town.

Standard Deduction: The bill specifies that personal swimming pools associated with a homestead qualify for a standard deduction.

Residential Circuit Breaker: This bill defines the term "common areas" for purposes of the circuit breaker credit law.

Sales Tax: The bill requires out-of-state businesses that have an affiliate or a closely related business located in Indiana to collect gross retail use taxes on Indiana sales.

Inheritance Tax: This bill provides for a phase-out of the Inheritance Tax.

"Zapper" Penalty: The bill imposes a Class C felony for sale, purchase, installation, transfer, or possession

of an automated sales suppression device ("zapper") or phantom-ware.

The bill also makes technical changes.

Effective Date: Upon passage; March 1, 2011 (retroactive); July 1, 2012.

Explanation of State Expenditures: *Department of State Revenue* (DOR): This bill will result in an increase in administrative costs for the DOR by requiring the DOR to revise Sales Tax forms to incorporate the provisions of this bill. The DOR reports that their existing level of resources is sufficient to implement this provision.

If the Inheritance Tax is repealed, there could be a savings to the state from a reduction in staff of the Inheritance Tax Section of the Department of State Revenue. The November 1, 2011, state staffing table indicates that the Inheritance Tax Division has 8 full-time employees with an annual salary of about $300,000. Since staff will be needed to process returns during the phaseout of the Inheritance Tax, a specific savings due to staff reductions could not be estimated.

Electronic Transmission: Under current law, the Department of Local Government Finance (DLGF) may require local governmental units to submit forms electronically. In addition, this bill would require the DLGF to work with the Office of Technology or a state educational institution to develop and maintain a web-based system for forms submission. Local governmental units would be required to use these systems as prescribed by the DLGF. The DLGF is already engaged in web-based submission projects so this provision would not add any additional state expenses.

"Zapper" Penalty: A Class C felony is punishable by a prison term ranging from 2 to 8 years, depending upon mitigating and aggravating circumstances. The average expenditure to house an adult offender was $18,836 in FY 2011. (This does not include the cost of new construction.) If offenders can be housed in existing facilities with no additional staff, the marginal cost for medical care, food, and clothing is approximately $3,318 annually, or $9.09 daily, per prisoner. The estimated average cost of housing a juvenile in a state juvenile facility was $75,591 in FY 2011. The average length of stay in DOC facilities for all Class C felony offenders is approximately two years.

Explanation of State Revenues: *Impact on Sales Tax Revenue*: This bill expands the definition of who qualifies as a "retail merchant". The definition expansion is effective July 1, 2012.The definition would require certain electronic commerce (e-commerce) entities to remit Sales Tax. This bill would increase Sales Tax revenue by an indeterminable amount. The amount of the increase would depend on the extent to which the definition change influences the location decision of a business entity.

Current statute requires that an individual pay use tax on online transactions on the individual's income tax return. In FY 2011, approximately $1.77 M was collected in Use Tax on the tax year 2010 individual income tax returns.

Background Information: The Main Street Fairness Act (HR 2701) was introduced in the U.S. House of Representatives on July 29, 2011, and was referred to the House Committee on the Judiciary. The Main Street Fairness Act which would allow states, provided they have met certain conditions to require Internet and mail order retailers to collect sales tax. The legislation would allow any state that has adopted the Streamlined Sales and Use Tax Agreement to collect sales and use taxes from remote sellers. There are currently 24 member states in compliance with the Streamlined Sales and Use Tax Agreement, including

Indiana.

A study conducted by the Indiana Fiscal Policy Institute and the Ball State University Center for Business and Economic Research examined how much revenue Indiana will lose in 2012 as a result of the absence of a tax on e-commerce transactions. The estimated revenue loss ranged from $39.6 M to $114.3 M. Additionally, the study examined the effect of a tax on e-commerce transactions on an e-commerce entity's location decision and found no statistically significant relationship. A University of Tennessee study estimated e-commerce-related annual Sales Tax losses in Indiana at $216.9 M for FY 2012.

Sales Tax revenue is deposited in the state General Fund (99.848%) the Commuter Rail Service Fund (0.123%), and the Industrial Rail Service Fund (0.029%).

Repeal of Inheritance Tax, Estate Tax, and Generation Skipping Tax: The bill would lead to progressively larger reductions in Inheritance Tax revenues from FY 2015 through FY 2025 when the tax would be eliminated and no longer generate revenue. The revenue loss from the phaseout is demonstrated in the table below.

Fiscal Year Impact	Inheritance Tax Revenue Loss
FY 2015	($14.9 M)
FY 2016	($29.7 M)
FY 2017	($44.6 M)
FY 2018	($59.4 M)
FY 2019	($74.3 M)
FY 2020	($90.8 M)
FY 2021	($105.6 M)
FY 2022	($120.5 M)
FY 2023	($135.3 M)
FY 2024	($150.2 M)
FY 2025	($165.0 M)

The bill also provides that the Estate Tax and Generation Skipping Transfer Tax do not apply after June 30, 2023. The bill could potentially have the following impacts on state revenues:

(1) Elimination of potential future revenue from the Indiana Estate Tax: The *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* (P. L. 111-312), signed into law on December 17, 2010, exempts the first $5 M ($10 M for married couples) of an estate from the Federal Estate Tax and applies a tax rate of 35% for 2011 and 2012. P. L. 111-312 also extended the state death tax deduction through 2012 (in lieu of the state death tax credit which was eliminated for the deduction in 2005). Under the state death tax deduction, Indiana does not collect Estate Tax because the tax is tied to the old state death tax credit instead. The extensions in P. L. 111-312 will sunset on December 31, 2012. It is unknown whether Congress will extend the current Federal Estate Tax after this date, create a new Estate Tax, or allow via inaction the Estate Tax as it existed in 2001 to return in 2013. It is also unknown what the applicable tax rate and exemption amounts will be in 2018 or whether a state death tax deduction or credit will be in place at that time. Annual Estate Tax collections totaled $20 M to $25 M immediately prior to the federal law changes in 2001.

(2) Elimination of potential future revenue from the Indiana Generation Skipping Transfer Tax: The revenue loss from elimination of the Generation Skipping Transfer Tax would be minimal. Since FY 1993, the tax reportedly generated no revenue except in FY 2004 ($31,254) and FY 2005 ($3,637).

Background Information - The bill phases out the Inheritance Tax by providing an increasing credit against a beneficiary's Inheritance Tax liability. The credit would apply to transfers made by persons who die within the dates specified in the following table. Since the Inheritance Tax must be paid within 12 months after the decedent's death (within 9 months to receive the 5% early payment discount), the bulk of the impact of the first year's credit (equal to 25%) would not be experienced until FY 2015.

Inheritance Tax Credit	Transfers made from persons dying . . .
9%	After June 30, 2013, and before July 1, 2014
18%	After June 30, 2014, and before July 1, 2015
27%	After June 30, 2015, and before July 1, 2016
36%	After June 30, 2016, and before July 1, 2017
45%	After June 30, 2017, and before July 1, 2018
55%	After June 30, 2018, and before July 1, 2019
64%	After June 30, 2019, and before July 1, 2020
73%	After June 30, 2020, and before July 1, 2021
82%	After June 30, 2021, and before July 1, 2022
91%	After June 30, 2022, and before July 1, 2023
100%	After June 30, 2023

The estimated impact of the phaseout of the Inheritance Tax is based on the Revenue Technical Committee's FY 2012 forecast (published December 14, 2011). This forecast estimates FY 2012 Inheritance Tax at $165 M. The estimated revenue loss from the exemption assumes that Inheritance Tax revenues would remain relatively constant in the future, absent the phaseout.

"Zapper" Penalty: If additional court cases occur and fines are collected, revenue to both the Common School Fund and the state General Fund would increase. The maximum fine for a Class C felony is $10,000. Criminal fines are deposited in the Common School Fund.

If the case is filed in a circuit, superior, or county court, 70% of the $120 criminal costs fee that is assessed and collected when a guilty verdict is entered would be deposited in the state General Fund. If the case is filed in a city or town court, 55% of the fee would be deposited in the state General Fund. In addition, some or all of the document storage fee ($2), automated record keeping fee ($5), judicial salaries fee ($19), public defense administration fee ($5), court administration fee ($5), judicial insurance adjustment fee ($1), and the DNA sample processing fee ($2) are deposited into the state General Fund.

Explanation of Local Expenditures: *Business Preference*: The bill will have indeterminate impact on supply purchases of a local unit of government, potentially decreasing costs. The purchasing preferences are awarded during the evaluation of bids and are a factor in determining who will be awarded contracts. The actual bid price does not change. As a result, a bidder with a bid higher than the lowest price may be accepted. Under the bill, the price preference is optional and applicable only if the political subdivision states in the solicitation for supplies that the preference will apply.

Additionally, the bill clarifies that the local government public works project applies to projects that will cost at least $150,000, or for a project by a board of aviation commissioners, $100,000.

"Zapper" Penalty: If more defendants are detained in county jails prior to their court hearings, local expenditures for jail operations may increase. The average cost per day is approximately $44.

Explanation of Local Revenues: *Personal Property:* This proposal would permit counties, cities, and towns to adopt an ordinance that provides either a 100% deduction for business personal property. If adopted by the county, the deduction or credit would apply countywide.

If the deduction is adopted by October 1st, it would apply beginning with the next assessment date. If adopted after September 30th, the deduction would apply beginning with the second assessment date following adoption.

If the credit is adopted by October 1st, it would apply beginning with taxes payable in the following year. If adopted after September 30th, the credit would apply beginning with taxes due in the second year following adoption.

The 100% deduction for personal property would shift property taxes from personal property to real property owners. Property tax rates would increase and circuit breaker losses would rise. In addition, the levies of rate-controlled funds would be reduced.

The credit for personal property would create a loss of property tax revenue to civil taxing units and school corporations. Tax rates would not be affected and there would be no shift to real property owners. There would be no change in circuit breaker credit losses related to real property.

In CY 2011, the gross levy attributed to personal property was $964 M, statewide. An additional $58 M in gross tax on personal property was attributed to TIF districts. The total net tax including net tax attributed to TIF after all credits including circuit breakers was $949 M. The adoption of the deduction or credit would be a local decision.

Standard Deduction: Under current law, homesteads receive a standard deduction worth 60% of assessed value (AV) up to a maximum of $45,000. They also receive the supplemental standard deduction worth 35% of the first $600,000 of net AV after the standard deduction plus 25% of the net AV that exceeds $600,000. In addition, several counties offer LOIT- funded property tax credits against the tax liability of homestead property. Homestead property is subject to a 1% circuit breaker cap rather than the 2% cap for nonhomestead residential property.

Swimming pools on the grounds of a homestead do not qualify for the standard deductions or the 1% tax cap. Instead swimming pools are subject to a 3% tax cap. Beginning with property taxes payable in 2012, this bill would remove the swimming pool exclusion so that pools would be eligible for the standard deductions and the 1% tax cap.

For taxes payable in 2011, there were about 124,000 swimming pools with an AV of $771 M on homestead property. The additional homestead deductions would total about $270 M in AV. Beginning with 2012 taxes, these deductions would cause an small increase in tax rates creating a net shift to other taxpayers of approximately $2 M per year. In addition, the increased tax rates and the qualification of swimming pools under the 1% cap would lead to increased circuit breaker losses of approximately $4 M per year. TIF proceeds would also rise by about $250,000 to $350,000 per year. Total property tax savings for homeowners with swimming pools is estimated at $5.5 M per year.

Property tax rates for 2012 must be finalized by February 15, 2012. Since this bill is effective with 2012 taxes, it is likely that counties would either have to issue corrected tax bills or delay 2012 tax bills so that the original tax bill reflects the new tax rates, deductions, and tax caps.

Residential Circuit Breaker: Under current law, residential property that is not a homestead is subject to the 2% circuit breaker cap. Nonhomestead residential property includes the dwelling, common areas, and land matching the building footprint. This bill would define common areas to include roads, swimming pools, tennis courts, basketball courts, playgrounds, carports, garages, other parking areas, gazebos, decks, and patios. Most of these items currently qualify under the 3% circuit breaker cap but would qualify for the 2% cap under this bill.

CY 2011 tax bills for apartments and other non-homestead residential property were examined to estimate the fiscal impact of this provision. The application of the 2% cap to the entire property would have reduced net taxes and increased revenue losses due to the circuit breaker in CY 2011 by about $20.8 M.

Circuit Breaker Summary: The total increase in circuit breakers due to the changes in the definitions of homesteads and nonhomestead residential property is estimated at $25 M per year. This estimate does not include any impact from the optional 100% deduction for personal property also found in this bill.

Impact on Sales Tax Revenue: Local revenues will be impacted to the extent that a local unit receives funds from the Commuter Rail Service Fund or the Industrial Rail Service Fund.

Repeal of Inheritance Tax: The phaseout of the Inheritance Tax could result in an annual revenue loss to counties beginning in FY 2015.

Fiscal Year Impact	Local Share of Inheritance Tax Revenue Loss
2015	($1.3 M)
2016	($2.6 M)
2017	($3.8 M)
2018	($5.1 M)
2019	($6.4 M)
2020	($7.8 M)
2021	($9.1 M)
2022	($10.4 M)
2023	($11.7 M)
2024	($13.0 M)
2025	($14.2 M)

The bill also phases out replacement payments paid from the state General Fund to counties based upon replacement payments that they receive for any shortage of Inheritance Tax revenue in FY 2013 (the fiscal year before the Inheritance Tax begins to be phased out by this bill). Thirteen counties received less revenue than is guaranteed by statute for FY 2011, totaling about $108,000. Replacement payments have averaged about $113,000 since FY 2006. Because most counties retain more in Inheritance Tax revenues than is guaranteed in the replacement statute, most counties will not receive replacement payments. Using the average, the phaseout of replacement payments provided in this bill is shown in the table below. Replacement payments will end in FY 2024.

Fiscal Year Impact	Phaseout Percentage	New Replacement Payments (Aggregate)
2014	91%	$103,000
2015	82%	$93,000
2016	73%	$82,000
2017	64%	$72,000
2018	55%	$62,000
2019	45%	$51,000
2020	36%	$41,000
2021	27%	$31,000
2022	18%	$20,000
2023	9%	$10,000

Background Information - Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents and are guaranteed a statutorily determined amount from the Inheritance Tax under P.L.254-1997. This legislation increased the Class A exemption to $100,000, effective July 1, 1997, and required the state to annually transfer money from the state General Fund to counties to replace county Inheritance Tax revenue lost due to the exemption increase. The replacement provision guarantees that each county receive an amount of Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997, excluding the highest year and lowest year. The total annual guarantee to counties is approximately $7.4 M.

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

"Zapper" Penalty: If additional court actions occur and a guilty verdict is entered, local governments would receive revenue from the following sources: The county general fund would receive 27% of the $120 criminal costs fee that is assessed in a court of record. Cities and towns maintaining a law enforcement agency that prosecutes at least 50% of its ordinance violations in a court of record may receive 3% of the criminal costs fee. In addition, several additional fees may be collected at the discretion of the judge and depending upon the particular type of criminal case.

State Agencies Affected: Department of State Revenue; Department of Correction; Department of Local Government Finance.

Local Agencies Affected: Counties; civil taxing units and school corporations; Trial courts; Local law enforcement agencies.

Information Sources: *To Collect Sales Tax or Not: Indiana's Ecommerce Conundrum - Determining the State's Lost Sales Tax Revenue and Weighing the Amazon Tax Policy.* Indiana Fiscal Policy Institute, November 2011. Streamlined Sales Tax Governing Board, http://www.streamlinedsalestax.org/;
H.R. 2701 Bill Text, S.1452 bill Text, Library of Congress; Tom Conley, DOR, 317-232-8039; Revenue Technical Committee, *State Revenue Forecast, Fiscal Years 2012 and 2013,* December 14, 2011; Quarterly Inheritance Tax Reports, FY 1997- FY 2011; LSA property tax databases; Indiana Sheriffs' Association; Department of Correction.

Fiscal Analyst: Bob Sigalow, 317-232-9859; Karen Firestone, 317-234-2106; Diana Agidi, 317-232-9867; Jessica Harmon, 317-232-9854.